

EXHIBIT 1

DATE 3-10-13

HB 5



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Director
AMY CARLSON

DATE: February 25, 2013

TO: Sen. Jeff Essmann, Senate President
Rep. Mark Blasdel, House Speaker
Sen. Bruce Tutvedt, Chair, Senate Tax Committee
Rep. Mike Miller, Chair, House Tax Committee
Sen. Art Wittich, Senate Majority Leader
Rep. Gordon Vance, House Majority Leader
Sen. Jon Sesso, Senate Minority Leader
Rep. Chuck Hunter, House Minority Leader

FROM: Amy Carlson, Legislative Fiscal Analyst
Stephanie Morrison, Revenue Analyst

RE: General Fund Revenue Update #1

PURPOSE OF REPORT

This is the first of the monthly revenue updates throughout the session designed to brief the legislature on recent economic trends and the corresponding outlook for the 2015 biennium General Fund revenue estimate. This update is based on actual revenue collections received through the end of January 2013, and updated national and Montana forecasts from IHS Global Insight (IHS).

SUMMARY

General fund revenue collections continue to show strong growth over FY 2012 amounts, and are currently somewhat above the overall growth contained in SJ 2. Underlying economic indicators have improved slightly since the IHS January forecasts were used to develop the estimate contained in SJ 2. Most of the higher-than-anticipated growth in year-to-date collections may be a result of revenue shifting due to the uncertainty in future federal tax rates at the end of CY 2012.

If the IHS February forecasts and an adjustment for revenue shifting into calendar year 2012 are used in the LFD revenue models, total general fund revenue estimates increases by \$65.5 million over the three-year forecast period. The table below shows the Legislature's official total general fund estimate as contained in SJ 2 and the model output based on the revised assumptions. The table also compares the year-to-date growth in collections with the growth rate contained in SJ 2 and the growth rate based on the new data.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$1,871.0	\$1,871.0				
2013	1,995.0	2,021.5	\$26.6	8.8%	6.6%	8.0%
2014	2,056.3	2,074.9	18.6		3.1%	2.6%
2015	2,137.4	2,157.7	20.3		3.9%	4.0%
3-YR	\$6,188.6	\$6,254.2	\$65.5			

The revised national forecast from IHS is based on the following key assumptions:

- Improving economy fundamentals, particularly in housing, but federal policy headwinds still a drag
- Rebounding GDP growth in the first quarter 2013 after the small decline in the fourth quarter 2012
- A limited, temporary sequester in federal spending
- Continued quantitative easing by the Federal Reserve into 2014, with the federal funds rate near zero until late 2015
- Increased oil price due to geopolitical fears rather than higher oil demand
- Revised Census Bureau estimates showing reduced immigration and a more rapidly aging population

The revised Montana forecast from IHS is based on the following key assumptions:

- Increased wage growth
- A more rapidly aging population

The summary of changes to SJ 2 by income source is shown in the table below, which also includes the proposed changes to the guarantee account estimate. The improvement in the overall estimate is being driven primarily by the increase in individual income tax and corporate license tax. The increase in individual income tax is due to higher wage disbursements, increased oil prices, and a larger elderly population. The increase in corporation license tax is due to higher S&P 500 growth and increased oil prices.

Summary of Changes from SJ 2				
	FY 2013	FY 2014	FY 2015	Total
Individual Income Tax	\$26.8	\$13.0	\$16.1	\$55.9
Property Tax	-	-	-	-
Corporation License Tax	3.1	3.3	2.7	9.1
Vehicle Taxes & Fees	0.0	0.1	0.1	0.2
Oil & Natural Gas Tax	(3.0)	2.9	2.2	2.2
Insurance Tax	(0.2)	(0.2)	(0.2)	(0.5)
Video Gaming Tax	-	-	0.0	0.0
Remaining Sources	(0.2)	(0.4)	(0.6)	(1.2)
General Fund Total	\$26.6	\$18.6	\$20.3	\$65.5
Guarantee Account	(2.6)	(8.2)	(7.3)	(18.2)
Total General Fund & Guarantee	\$24.0	\$10.4	\$13.0	\$47.4

YEAR-TO-DATE COLLECTIONS

FY 2013 general fund revenues through the end of January are \$94.6 million or 8.8% ahead of FY 2012 revenues through the same period; this increase is above the anticipated growth of 6.6%. The difference can almost entirely be attributed strong growth in individual income and corporate license tax collections.

General Fund Revenue Monitoring Report							
(in Millions)							
Revenue Source	Actual FY 2012	SJ2 Estimate FY 2013	SJ2 Estimate % Change	1/31/2012 FY 2012	1/31/2013 FY 2013	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	\$898.851	\$983.953	9.5%	\$620.492	\$695.723	\$75.231	12.1%
Property Tax	236.662	241.741	2.1%	124.460	130.745	\$6.285	5.0%
Corporation Tax	127.771	150.658	17.9%	74.875	94.807	\$19.932	26.6%
Vehicle Taxes & Fees	99.954	100.833	0.9%	50.283	49.702	(\$0.581)	-1.2%
Oil Severance Tax	97.560	98.750	1.2%	25.508	23.736	(1.771)	-6.9%
Insurance Tax	58.951	59.932	1.7%	24.170	25.240	\$1.070	4.4%
Video Gaming Tax	53.824	57.706	7.2%	25.116	28.156	\$3.040	12.1%
Other Business Taxes							
Drivers License Fee	4.369	3.867	-11.5%	2.297	2.593	0.296	12.9%
Estate Tax	0.060	0.000	-100.0%	0.058	0.001	(0.058)	-99.0%
Investment Licenses	6.961	7.210	3.6%	6.046	6.004	(0.043)	-0.7%
Lodging Facilities Sales Tax	15.606	17.314	10.9%	7.523	8.135	0.611	8.1%
Public Contractor's Tax	(3.042)	1.140	-137.5%	(1.141)	(0.024)	1.116	-97.9%
Railroad Car Tax	2.273	2.157	-5.1%	1.790	1.637	(0.153)	-8.5%
Rental Car Sales Tax	3.420	3.539	3.5%	1.869	1.974	0.105	5.6%
Retail Telecom Excise Tax	21.459	22.606	5.3%	5.717	6.233	0.516	9.0%
Other Natural Resource Taxes							
Coal Severance Tax	12.350	12.864	4.2%	6.111	7.578	1.467	24.0%
Electrical Energy Tax	4.481	4.442	-0.9%	1.492	1.896	0.404	27.1%
Metal Mines Tax	10.010	10.904	8.9%	0.002	0.037	0.035	1451.6%
U.S. Mineral Royalties	31.057	36.989	19.1%	14.424	14.196	(0.229)	-1.6%
Wholesale Energy Trans Tax	3.427	4.038	17.8%	0.981	1.817	0.837	85.3%
Other Interest Earnings							
Coal Trust Interest Earnings	25.840	24.451	-5.4%	11.067	10.746	(0.321)	-2.9%
TCA Interest Earnings	2.654	2.779	4.7%	1.195	1.351	0.155	13.0%
Other Consumption Taxes							
Beer Tax	2.956	3.052	3.2%	1.569	1.603	0.034	2.1%
Cigarette Tax	31.483	30.991	-1.6%	17.971	17.784	(0.187)	-1.0%
Liquor Excise Tax	17.037	18.206	6.9%	8.884	9.441	0.557	6.3%
Liquor Profits	9.500	10.604	11.6%	-	-	-	-
Lottery Profits	13.061	14.477	10.8%	2.369	2.685	0.316	13.3%
Tobacco Tax	5.709	5.821	2.0%	2.908	3.008	0.100	3.5%
Wine Tax	2.104	2.144	1.9%	1.126	1.181	0.055	4.8%
Other Sources							
All Other Revenue	47.258	32.595	-31.0%	31.555	16.081	(15.474)	-49.0%
Highway Patrol Fines	4.385	4.427	1.0%	2.196	2.016	(0.180)	-8.2%
Nursing Facilities Fee	5.077	4.876	-4.0%	1.966	3.022	1.056	53.7%
Public Institution Reimbursements	14.562	16.332	12.2%	5.815	6.223	0.408	7.0%
Tobacco Settlement	3.322	3.552	6.9%	-	-	-	-
Largest Seven Subtotal	\$1,573.574	\$1,693.573	7.6%	\$944.904	\$1,048.110	\$103.206	10.9%
Remaining Sources Subtotal	297.380	301.377	1.3%	135.792	127.216	(8.576)	-6.3%
Grand Total	\$1,870.954	\$1,994.950	6.6%	\$1,080.696	\$1,175.326	\$94.630	8.8%

Individual Income Tax

Individual income tax collections are \$75.2 million or 12.1% above last year. The estimate contained in SJ 2 forecasts a FY 2013 growth of 9.5%.

The IHS February forecast contained several revisions that impacted the model output: increased wage disbursements, higher oil prices, and a larger elderly population. These changes increased the individual income model output by about \$36 million over the three-year forecast period.

There is anecdotal evidence of taxpayers realizing capital gains and companies paying dividends to shareholders at the end of calendar year 2012 to take advantage of possibly lower federal tax rates. Pew Center on the States published a small report highlighting potential changes to state tax revenue due to this issue. California is anticipating an amount equal to 20% of the capital gains from 2013 will be accelerated into 2012; Oregon is anticipating an "April Surprise" equal to 20% of last year's April tax payments.

The individual income tax model output shown below contains a FY 2013 adjustment of \$20 million—approximately 20% of last year's April tax payments—to account for an expected change in taxpayer behavior. No reduction in FY 2014 and FY 2015 capital gains income is included since it is assumed the accelerated realization of gains would have otherwise been spread over several years in the future.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$898.9	\$898.9				
2013	984.0	1,010.7	\$26.8	12.1%	9.5%	12.4%
2014	1,039.2	1,052.1	13.0		5.6%	4.1%
2015	1,104.9	1,121.0	16.1		6.3%	6.5%
3-YR	\$3,128.0	\$3,183.9	\$55.9			

The detailed collection information for individual income tax is show below. Withholding tax is continuing a strong growth at 9.8% above last year's collections and estimated payments are up sharply.

Individual Income Tax				
	YTD FY 2013	YTD FY 2012	Difference	% Difference
Withholding	\$439.5	\$400.2	\$39.2	9.8%
Estimated Payments	151.7	118.1	33.6	28.4%
Current Year Payments	16.3	14.2	2.0	14.4%
Audit, P&I, Amended	14.5	13.5	1.0	7.1%
Refunds	(61.6)	(57.7)	(3.9)	6.8%
Refund Accrual Reversal	124.8	121.9	2.9	2.4%
Partnership Income Tax	3.9	2.7	1.3	46.6%
Mineral Royalties	6.6	7.5	(0.9)	-11.7%
Total	\$695.7	\$620.5	\$75.2	12.1%

Property Tax

The property tax estimate is based on the taxable value data for tax year 2012 (FY 2013) obtained from Department of Revenue, so suggest FY 2013 growth will be close to the estimate of 2.1% contained in SJ 2. The property tax estimate does not use IHS data, so there is no change in the model output.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$236.7	\$236.7				
2013	241.7	241.7	\$0.0	5.0%	2.1%	2.1%
2014	246.6	246.6	-		2.0%	2.0%
2015	254.7	254.7	-		3.3%	3.3%
3-YR	\$743.0	\$743.0	\$0.0			

Corporation License Tax

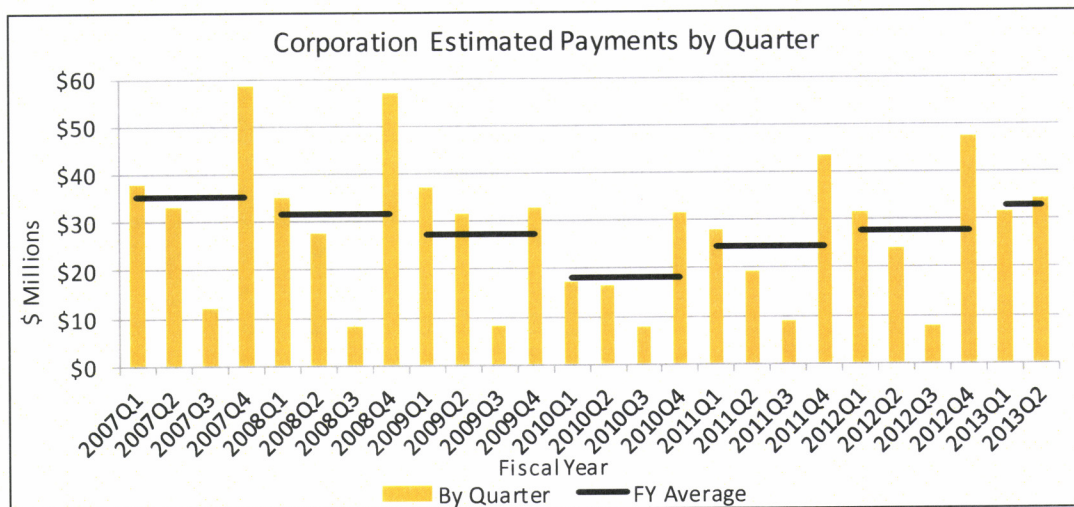
Corporation license tax collections are \$19.9 million or 26.6% above last year primarily due to an increase in estimated payments and a reduction in refunds. The estimate contained in SJ 2 forecasts a FY 2013 growth of 17.9%.

The IHS February forecast contained two revisions that produced higher corporation license tax revenue estimates: higher oil prices and stronger S&P 500 growth. These changes increased the three-year estimate by about \$9 million. Refunds are unusually low, and if this pattern continues, total collections may be even higher than anticipated. Based on historical collection averages, there is not a compelling case to change the refund estimate; however, there are likely more upside risks than downside risks to the overall estimate.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$127.8	\$127.8				
2013	150.7	153.8	\$3.1	26.6%	17.9%	20.4%
2014	154.1	157.4	3.3		2.3%	2.3%
2015	155.0	157.7	2.7		0.6%	0.2%
3-YR	\$459.8	\$468.9	\$9.1			

Corporation License Tax					
	YTD FY 2013	YTD FY 2012	Difference	% Difference	
Corporation Tax	\$11.2	\$6.8	\$4.4	65.8%	
Estimated Payments	\$69.2	\$57.5	\$11.7	20.4%	
Refunds	(\$9.6)	(\$17.0)	\$7.4	-43.7%	
Refund Accrual Reversal	\$12.8	\$9.0	\$3.7	41.3%	
Audit, P&I, Amended	\$11.3	\$18.7	(\$7.4)	-39.6%	
Total	\$94.8	\$74.9	\$19.9	26.6%	

The best indicator for corporation license tax collections is estimated payments. As shown in the figure below, estimated payments are volatile from year-to-year and quarter-to-quarter. Since the low point during FY 2010, estimated payments have (on average) been increasing. FY 2013 estimated payments through the second quarter at the end of December show a continuation of this trend.



Vehicle Tax & Fees

Vehicle fees and taxes are currently below last year's amount by \$0.6 million or 1.2%. The estimate contained in SJ 2 forecasts a growth of 0.9% in FY 2013.

The IHS February forecast did include small Montana vehicle stock changes, which are reflected in the slight revenue increase shown in the model output.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$100.0	\$100.0				
2013	100.8	100.9	\$0.0	-1.2%	0.9%	0.9%
2014	101.4	101.5	0.1		0.5%	0.6%
2015	102.1	102.2	0.1		0.7%	0.7%
3-YR	\$304.3	\$304.5	\$0.2			

Oil & Natural Gas Production Tax

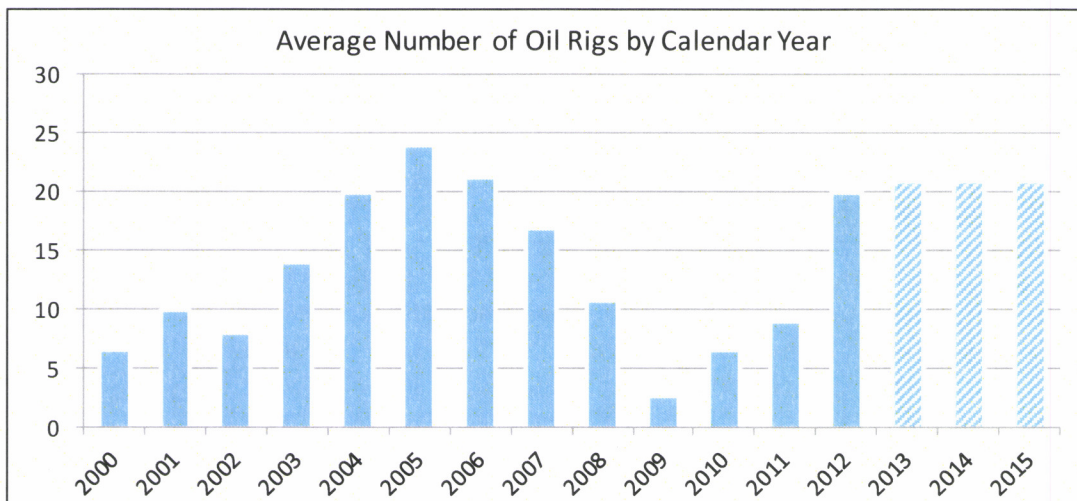
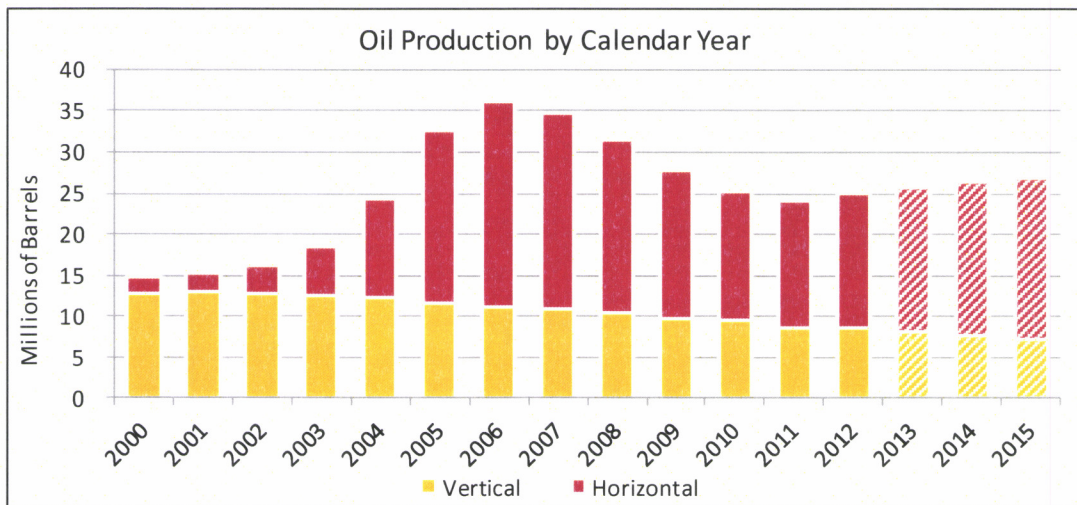
Oil and natural gas production tax collections are \$1.8 million or 6.9% below last year as of the end of January. These revenue collections represent the taxes on production from the first quarter of FY 2013. The estimate contained in SJ 2 forecasts a FY 2013 growth of 1.2%.

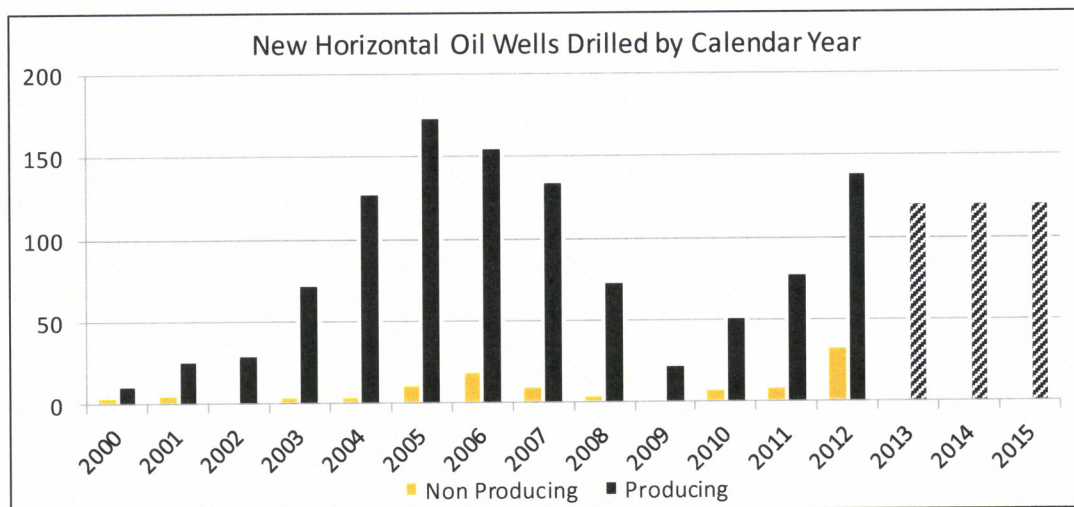
The IHS February forecast increased oil prices and decreased natural gas prices. In addition to updated price data, several new months of production data has become available. The oil and natural gas production tax estimate contained in SJ 2 was based on January price data, but the most recent production data came from June 2012. The model output shown in the table below is based on production data through December 2012.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$97.6	\$97.6				
2013	98.8	95.8	(\$3.0)	-6.9%	1.2%	-1.8%
2014	99.3	102.3	2.9		0.6%	6.8%
2015	97.4	99.6	2.2		-1.9%	-2.6%
3-YR	\$295.5	\$297.7	\$2.2			

Oil Production

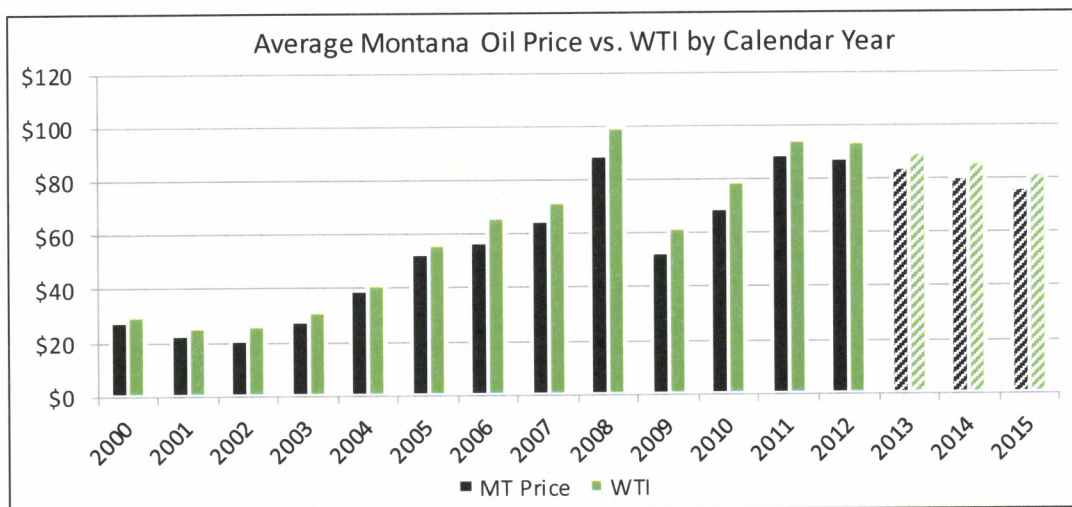
The slow growth in overall oil production is attributable to the continuing decline of production from vertical wells; horizontal production appears to be growing again after five consecutive years of decline following the 2006 peak.





Oil Price

The forecast oil prices shown in the graph below are those contained in SJ 2.



Insurance Tax

Insurance tax collections are up \$1.1 million or 4.4% over last year. The estimate contained in SJ 2 forecasts a growth of 1.7% in FY 2013. One of the economic variables used to model insurance tax collections is the number of Montana house starts forecast by IHS. According to the Bureau of Business and Economic Research at the University of Montana, the IHS forecast significantly under-represents the growth in rural areas, which is where a large share of housing growth is occurring. If so, this may account for much of the difference between estimated and actual collections. Further research needs to be done on this issue, and it may result in modeling on a more representative variable.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$59.0	\$59.0				
2013	59.9	59.7	(\$0.2)	4.4%	1.7%	1.3%
2014	52.0	51.8	(0.2)		-13.2%	-13.2%
2015	54.1	53.9	(0.2)		3.9%	4.0%
3-YR	\$166.0	\$165.5	(\$0.5)			

Video Gambling Tax

Video gaming tax collections are up \$3.0 million or 12.1% over last year, primarily due to the addition of video line games approved by the 62nd Legislature. The positive impact of this legislation is expected to continue with some modest improvement in overall machine play. The estimate contained in SJ 2 forecasts a growth of 7.2% in FY 2013.

The IHS February forecast did not change Montana per capita personal income significantly; therefore the model output remained the same.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$53.8	\$53.8				
2013	57.7	57.7	\$0.0	12.1%	7.2%	7.2%
2014	59.9	59.9	-		3.9%	3.9%
2015	62.1	62.1	-		3.7%	3.7%
3-YR	\$179.8	\$179.8	\$0.0			

Remaining Sources

Revenue from the remaining sources was 6.3% below FY 2012, primarily due to timing in all other revenue. All other revenue collections are \$15.5 million below last year at this time due to fund transfers in HB 604 and revised laws regarding stale-dated warrants in SB 335, both passed by the 62nd Legislature. In FY 2012, \$10.9 million was transferred to the general fund per HB 604, and the unusually high \$3.2 million in abandoned property transfer reflected the changes due to SB 335.

The IHS February forecast resulted in very small changes—both positive and negative—to most of the remaining sources. In aggregate, this resulted in slightly decreased model output, as shown in the table below.

FY	SJ 2 Official Estimates	Feb 25 Model Output	\$ Difference	YTD Revenue Growth	SJ 2 Estimated Growth	Feb 25 Model Growth
2012	\$297.4	\$297.4				
2013	301.4	301.2	(\$0.2)	12.1%	1.3%	1.3%
2014	303.7	303.3	(0.4)		0.8%	0.7%
2015	307.2	306.5	(0.6)		1.1%	1.1%
3-YR	\$912.2	\$911.0	(\$1.2)			

Guarantee Account

The guarantee account is used exclusively to pay Base aid to school districts. It is the first source of funding for Base aid and is statutorily appropriated. The amount of Base aid not paid for by the guarantee account is paid for from the general fund. Revenue in the guarantee account includes distributable interest from the investments at the Board of Investments, income from state trust lands, and excess oil and gas revenue from school districts.

The guarantee account trust lands revenue estimate is primarily based on the estimates for various income sources provided by the Department of Natural Resources and Conservation (DNRC). In November, the LFD substituted higher LFD estimates for trust lands for grazing and agricultural fees and natural resource bonus payments. With only about 4 months left of fiscal year 2013, the DNRC currently estimates bonus payments to be \$6 million lower than the November LFD estimate and grazing and agricultural fees to be \$3 million higher than the November LFD estimate. DNRC did not change forecasts for FY 2014 and FY 2015. The changes shown in the table below reflect the changes to the current DNRC estimates for FY 2013 as well as changes due to the LFD accepting the DNRC estimate for all trust land revenues for FY 2014 and FY 2015. If additional information becomes available, the LFD will reevaluate these estimates.

	SJ 2	Feb 25		SJ 2	Feb 25
	Official	Model	\$	Estimated	Model
FY	Estimates	Output	Difference	Growth	Growth
2012	\$102.4	\$102.4			
2013	68.1	65.5	(\$2.6)	-33.5%	-36.0%
2014	65.7	57.5	(8.2)	-3.5%	-12.2%
2015	62.0	54.7	(7.3)	-5.6%	-4.9%
3-YR	\$195.8	\$177.6	(\$18.2)		

WHAT TO WATCH FOR NEXT MONTH

New data will be released between now and the next report in mid-March. This data will be used to highlight changing economic trends and the corresponding impacts those changes may have on the general fund revenue estimate.

DATA SOURCES

- IHS National & Montana economic forecasts
- IHS reports and analysis
- SABHRS month-end data through February
- Board of Oil & Gas production data
- DOR selected tax return data